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**Private Sector
Participation (PSP) and
Regulation of Water
and Sanitation**

Final Summary Report

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Contents

INTRODUCTION.....	1
WEEK ONE.....	2
WEEK TWO	3
CONCLUSIONS.....	5
APPENDIX 1 – LIST OF PARTICIPANTS	7
APPENDIX 2 – WORKSHOP SCHEDULE.....	14

I. INTRODUCTION

The Institute for Public Private Partnerships (IP3) and Abt Associates, in cooperation with South Africa's Department of Water Affairs and Forestry (DWAF) and Department of Provincial and Local Government (DPLG), implemented the training workshop, "*Private Sector Participation (PSP) and Regulation of Water and Sanitation*", on October 9-19, 2001 in Cape Town, South Africa. The program was sponsored by the United States Agency for International Development (USAID) and administered through a task order under the Sustainable Urban Management (SUM) IQC. Seventeen participants from the national and provincial offices of DWAF and DPLG attended the nine-day program. See **Appendix 1** for a complete list of workshop participants.

The workshop was a comprehensive nine-day program on the strategies of and techniques for PSP, and best-practices and lessons learned in the regulation of water and sanitation services. It was designed to draw on both South African experiences and international best practices, and combined presentations, group discussions and case studies. The Faculty included the following local and international experts:

- **Matthew Hensley**, President, Institute for Public Private-Partnerships (IP3), Washington, DC
- **Kathleen Slattery**, Director, Water and Sanitation Practice, IP3, Washington, DC
- **Ross Kriel**, ASHIRA Consulting, South Africa
- **Scott Jazynka**, IP3 Associate, South Africa
- **Gugu Moloi**, Director, Municipal Infrastructure Investment Unit (MIIU), South Africa
- **Kholisile Mazaza**, Manager, PPP Resource Center, NBI, South Africa
- **Thuso Ramaema**, Commercial Director, WSSA, South Africa

Each day was divided in to two sessions: one in the morning (9:00-12:00) and one in the afternoon (1:00-4:00). The program was held at the University of Stellenboch, School of Public and Financial Management campus in Bellville. The following sections summarize the content of the workshop sessions. See **Appendix 2** for the workshop daily schedule.

II. WEEK ONE

Scott Jazynka discussed the rationale and process for PSP in the water and sanitation sector. His four sessions examined various restructuring and partnership strategies for PSP including the pros and cons of service contracts, management contracts, leases and concessions.

The sessions focused specifically on the need to allow the service provider to earn a reasonable rate of return and ensure sustainability. The investor will not invest unless he is guaranteed an adequate rate of return through the existence of a regulatory framework that safeguards his ability to charge a tariff that covers operations and maintenance (O&M) costs, debt service, taxes and profit.

Most of the discussions centered on setting tariffs that neither deter private investment nor take advantage of the customer at the same time.

The participants were primarily interested in:

1. Regulation of water and sanitation services and the role of municipalities in that process, including contract compliance and monitoring
2. What are some of the benchmarks to assess whether capacity building and community empowerment have taken place in any project – particularly in municipalities?

Kholisile Mazaza, Manager of the Public-Private Partnership (PPP) Resource Center, presented case studies on the Dolphin Coast transaction.

Mr. Mazaza provided an overview of the MIIU-directed Dolphin Coast Water and Sanitation Project, which was in response to the growing inability of the Dolphin Coast Municipality to provide water and sewerage services to its population. Prior to the Municipality's creation in 1995, water and sewerage services were the responsibility of the Port Natal Ebodwe Joint Services Board. The creation of the Municipality was followed shortly by the abolition of the Board, and the municipality faced immediate difficulties in assuming responsibility for water and sewerage service provision. Services in formal towns were extremely poor, and services in informal settlements were virtually non-existent. The Municipality had only a small staff responsible for maintenance and operation, with no technical or managerial advisors. By 1999, the population of the Dolphin Coast Municipality had increased from 28,000 in 1995 to 40,000, and it is expected to grow to 250,000 within the next 25 years. To improve water and sewerage services to the current population while adequately preparing for future needs, the Dolphin Coast Municipality engaged the Development Bank of Southern Africa to investigate options for the delivery of services. DBSA recommended that Dolphin Coast

award a concession contract to a private operator through full and open competition.

Thuso Ramaema, Commercial Director from WSSA, gave a presentation on the inconsistencies in the regulatory framework for water and sanitation in South Africa and the implications for private sector participation.

He provided an overview of the situation in the water and sanitation sector in South Africa with a particular emphasis on the political and legal obstacles to PSP. It was a lively and frank discussion in which Mr. Ramaema reviewed the main characteristics of the different tariff regulation regimes, namely Rate of Return (ROR), Price Cap and their variations, and how the lack of capacity at the municipal level is stalling the implementation of municipal service partnerships (MSPs). One of the suggested solutions was CAPACITY BUILDING AT THE MUNICIPAL LEVEL. Although MIIU is supposed to fill this void, it was felt that with only 5 staff they cannot carry out their mandate successfully. The preferred solution would be to provide the municipalities with adequate capacity to negotiate and monitor contracts with the private sector, an ability which at the moment seems to be sorely lacking.

The session underscored the crucial role played by the tariff in affecting demand and generating revenue over an extended time period.

III. WEEK TWO

The week began with a Roundtable Discussion in which participants had the opportunity to discuss with their colleagues their individual and institutional responsibilities, problems and possible solutions. The session was the first stage of the Action Planning process in which each participant presents an Action Plan that he/she will implement on-the-job (Copies of the Action Plans are attached in Appendix 4).

Each participant was allowed 10 minutes for a presentation and an additional 10 minutes for an open moderated discussion.

Matthew Hensley discussed best practices in regulatory framework design using case studies from Chile, Argentina, the United States (Indianapolis), Guinea and Egypt. His presentation focused on common regulatory design features in the water and wastewater sector and critical choices that governments must make with respect to:

- i) Degree of independence from Ministry
- ii) Separation of technical/economic regulation

- iii) National, provincial or local regulators
- iv) Profit vs. price control; what is reasonable?
- v) Monitoring outputs; techniques for setting affordable rates
- vi) Basis and criteria for appeals to regulatory decisions
- vii) Levels and degrees of regulatory discretion

Gugu Moloi provided an overview of the Municipal Infrastructure Investment Unit (MIIU) and its role in assisting municipalities to successfully implement MSPs by providing technical and financial assistance for feasibility and pre-feasibility studies. Most of the participants from DPLG seemed to be unclear as to the procedures for accessing MIIU funds, and Ms. Moloi took time to explain this. For MIIU to assist municipalities, it must receive a formal letter from the appropriate authorities requesting such assistance.

Ross Kriel provided an overview of the legal framework underpinning South Africa's water and sewerage sector and the difficulties in reconciling the rules and legislation at the national, municipal and local levels. Municipalities must consider numerous pieces of legislation when implementing MSPs. Because municipalities have difficulty understanding and therefore complying with the legislation, the result is that many MSPs are not undertaken.

Section 217 of South Africa's Constitution calls for transparent, fair, equitable and cost-effective, competitive procurement by all organs of state. The Competition Bill, and Public Finance Management Act along with Treasury Regulations and Procurement Guidelines issued by the Department of Finance's Public-Private Partnership (P3) unit prescribe procedures and set standards for PSP procurement and contracting. Accounting officers can only sign P3 contracts if they comply with PFMA Treasury Regulations (financial accountability). The Labour Relations Act, stakeholder consultancies and other legislation also define the legal nature of PSP arrangements. The Water Services Act and the National Water Act define the minister's discretion and step-in rights with respect to tariff setting. This and companion legislation on empowerment deal with statutory requirements affecting different geographical areas and socio-economic segments of society.

Mr. Kriel stressed to participants that they do not need to know the intricate details of legislation. Rather, they need a general awareness of them in order to better assist municipalities to implement successful MSPs that will not be challenged in court or add costs to the projects. He suggested that it would be worthwhile for DWAF, DPLG, or USAID to compile and produce a guidebook for municipalities and local governments with a checklist of all the different rules and legislations that need to be adhered to for MSPs, similar to the one produced by the Department of Treasury P3 Unit.

Kathleen Slattery provided an overview of the legal aspects of procurement, contracting, and enforcement of PSP contracts within the South African framework. The presentation focused on the importance of adhering to international “best practices” to provide a confidence level to foreign investors and financial institutions, stressing the importance of negotiating contracts within the context of South Africa’s Constitution.

Effective procurement guidelines permit both parties to comply with the contract, and to be able to have prompt and fair settlement of any disputes that may arise during performance. Contractual provisions set forth performance standards, monitoring procedures, penalties (including liquidated damages for delay or non-compliance), and bonuses (for exceptional work). Participants reviewed the key clauses covering termination by either party and compensation in such event, how to deal with force majeure; and arrangements for renewal, extension or modification.

Her three sessions stressed the importance of including provisions in contracts to permit performance monitoring and the need to establish key performance indicators that provide benchmarks and milestones for evaluating progress.

During the last day each participant made a presentation on their Action Plan, which addressed the action necessary to address a specific issue, challenge, or problem they are facing on-the-job, as well as a timetable for implementation.

IV. CONCLUSIONS

A number of issues emerged out of the presentations and discussions with the participants. These are included below.

1. There was consistent debate and disagreement amongst the participants on the nature and structure of new regulatory body. Key discussion points focused on:
 - a. The location of the body and whether it will be under DWAF or will be an independent agency;
 - b. The degree to which regulation should be decentralized;
 - c. The appropriate scope of regulation (i.e. whether a regulatory body should regulate price, quality, or both); and
 - d. The source of funding for a regulatory body.
2. There was continued concern for additional capacity building at the national, provincial and local levels on the nature and implementation of MSPs or PSP arrangements.

3. Labor seems to be a big impediment to any realistic progress on MSPs or PSP. This is mainly due to their perception that MSPs are the same as privatization and all of its implied negative consequences. It was suggested that representatives of labor be included in future workshops of this kind to dispel some of their concerns and to engage them in a positive discussion on solutions to resolve the crisis affecting the water and sanitation sector in RSA.
4. Many participants found the training to be useful but believed that for meaningful change to occur, people at the most senior levels within DWAF and DPLG needed to participate. One recommendation was to hold another, shorter training session that might be easier for senior managers to attend.
5. Participants noted that there is some inconsistency within different South African legislation and regulations relating to the water sector. They identified a clear need for a study to review the legal and regulatory framework, and make recommendations for harmonization.

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APPENDIX 2 – WORKSHOP SCHEDULE

Institute for Public-Private Partnerships Week 1

Time	Tuesday	Wednesday	Thursday	Friday
8:30 am – 12:00 pm	Workshop Orientation Opening Remarks ----- Rationale & Strategies for Water Utility -Private Partnerships, Regulation & Stakeholder Consultation - <i>Scott Jazyuka</i> -	Funding Sources for PSP Water Projects The BOT Model The Pre-Feasibility Study - <i>Scott Jazyuka</i> -	CASE STUDY Dolphin Coast, South Africa Water and Sanitation Project - <i>Kholisile Mazaza</i>	Developing and Implementing Regulations for the Water Utilities Sector <i>ACTION PLANNING</i> PSP in the Water Sector: The Perspective of the Private Sector - <i>Thuso Ramaema</i>
12:00pm – 1:00pm	LUNCH			
1:00 pm – 4:30 pm	South African Priorities in Water Utility Restructuring, Public- Private Partnerships, Regulation & Stakeholder Consultation <i>Participant Presentations</i>	Strategic Planning and Technical Support Services – Applying Value for Money Affordability Criteria under PFMA - <i>Scott Jazyuka</i> -	Financial Analysis Strategies for Water Projects and Tariff Setting Strategies and Techniques for Competitive Water/Sanitation Utility Management - <i>Scott Jazyuka</i> -	Participant Roundtable Discussion

Institute for Public-Private Partnerships Week 2

Time	Monday	Tuesday	Wednesday	Thursday	Friday
8:30 a.m. – 12:00 p.m.	Participant Roundtable Discussion	Best Practices in Regulatory Framework Design - <i>Matthew Hensley</i> -	Legal and Regulatory Framework for Water and Sanitation in RSA - <i>Ross Kriel</i> -	Key Elements to the Agreement and Security Package: Risk Allocation, Post-Award Contract Compliance, and Performance Monitoring Best Practices in Regulating Water and Sanitation - <i>Kathleen Slattery</i> -	Action Plan Presentations and Discussions Workshop Conclusion and Evaluations - <i>Alioune Fall</i> -
12:00p.m. – 1:00 p.m.	LUNCH				
1:00 p.m. – 4:30 p.m.	Participant Action Plan Development - <i>Alioune Fall</i> -	The Municipal Infrastructure Investment Unit (MIIU): Presentation on the Role of MIIU in Water Prefeasibility Studies - <i>Gugu Maloi</i> - Water/Sanitation Project Procurement: Creating a Competitive and Transparent Environment - <i>Kathleen Slattery</i> -	Understanding the Legal Issues to Procure, Draft, and Monitor Water Projects – Section 217 of South Africa’s Constitution - <i>Ross Kriel</i> -	Contract Compliance and Performance Monitoring: The Role of Municipal Level Monitoring Units - <i>Kathleen Slattery</i> -	